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SUBJECT: New Delhi Weekly Econ Office Highlights for the Week of
July 6-10, 2009

REFTEL: NEW DELHI 1401

¶1. (U) Below is a compilation of economic highlights from Embassy New Delhi for the week of July 6-10, 2009, including the following:

-- Sharma Sees Recovery Signs in Exports
-- Update on India's Balance of Payments
-- Price Rise for Petrol and Diesel
-- Lower House of Parliament Passes Railway Budget
-- Reforms Have Life Outside of Budget
-- US-India Advance Cooperation on Biofuels Program under the Energy Dialogue

Sharma Sees Recovery Signs in Exports

¶2. (SBU) Commerce and Industry Minister Anand Sharma told Parliament this week that India's exports are now starting to respond to the stimulus packages announced by the Government of India (GOI) during the past six months. Sharma commented that, "The figures for the last three months indicate that there is now a turnaround which is visible ". Stimulus measures since October 2008 including easier credit availability, larger import duty rebates, and a service tax exemption to lower costs for exporters. According to the preliminary data released by the Commerce Ministry, merchandise exports from India dropped 29 percent in May 2009 to $11 billion compared with the May 2008 level, after sliding 33 percent in April 2009, which was the biggest decline so far during the decade. [Comment: Sharma's views that there may be green shoots in the Indian export sector seem very optimistic and based on a few data points. At best, the rate of decline in this sector seems to have stabilized in the past few months and may possibly have troughed for this cycle. However, a return to early 2008 growth levels may still be some time off. End comment.]

¶3. (U) Industry and government sources continue to cite the impact of the global recession for the fall in demand in markets abroad, particularly traditional destinations which include the U.S., UK, EU and Japan. A GOI labor bureau survey for the October-December 2008 period estimated 500,000 jobs had been cut due to declining exports.

The survey covered mainly 10 export sectors, namely, mining, textiles, metals, automobiles, gems and jewelry, transport, construction, computer services, leather and hand-made textiles. A follow up survey for the January-March quarter indicated some improvement in employment in the covered sectors, by as much as 250,000.

Update on India's Balance of Payments

¶4. (U) India's balance of payments (BoP) turned a modest surplus of $0.3 billion in the last quarter (January-March 2009) of FY 2008-09 after registering a deficit in the previous two quarters (July-December). The current account for January-March stood at a surplus of $4.7 billion, a marked improvement from the deficits of $13 billion in each of the earlier two quarters. The trade deficit fell sharply to $14.5 billion in the last quarter vis-`-vis an average of $35 billion in the previous three quarters, mainly due to the steep fall in imported crude prices. Exports for the quarter totaled $40 billion from an average of $45 billion during the first three quarters of FY 2008-09. The capital account deficit widened to $5.3 billion in the fourth quarter (versus $4.3 billion during the previous quarter) due to net outflows of banking capital, portfolio investment and short-term trade credit, although foreign direct investment (FDI) saw a recovery in the fourth quarter. FDI inflows totaled $3 billion in the fourth quarter, an increase of $0.4 billion over the third quarter.

¶5. (U) For the full FY 2008-09, the current account deficit rose to $29.8 billion (2.6% of GDP), from $17 billion a year ago, driven by the widening trade deficit ($119 billion in FY 2008-09) due to

higher oil prices and a fall in export demand. (Note: India's trade deficit is likely to narrow to $88 billion in FY 2009-10 due to lower oil prices and newer hydro carbon discoveries. End note.) In the current account, net invisibles (software, travel and remittances) totaled $89.6 billion during FY 2008-09 versus $74.6 billion in the FY 2007-08, showing more buoyancy than many expected. Software exports rose by 19% to touch $44.2 billion versus $37.2 billion in the previous year. Similarly remittances have held up with inflows at $44 billion in FY 2008-09 versus $41.7 billion in FY 2007-08. If this trend continues in FY 2009-10, overall invisibles would more than offset the trade deficit, thereby resulting in a current account surplus.

¶6. (U) Capital flows registered a massive slowdown to $9.1 billion during full FY 2008-09 from $108 billion in FY 2007-08, despite higher FDI and non-resident Indian deposits. FDI during FY 2008-09 remained steady at $35 billion, compared to $34.2 billion in FY 2007-08. The manufacturing sector witnessed the highest FDI inflows followed by the financial services and construction sector. FDI inflows reflect the attractiveness of India as a long-term investment destination. NRI deposits witnessed higher inflows since September 2008, responding to government permitted hikes in the interest rate ceilings of such deposits. On the other hand, foreign institutional investors pulled out $15 billion during FY 2008-09 due to the slowdown in the global economy and heightened uncertainty. Net External commercial borrowings slowed down to $8.2 billion in FY 2008-09 compared to $22.6 billion in FY 2007-08, mainly due to tight liquidity conditions in the overseas markets. Citigroup's India economist expects capital flows to recover to $44 billion in FY 2009-2010, given an improvement in risk appetite in the coming months.

Price Rise for Petrol and Diesel

¶7. (U) GOI's Ministry of Petroleum and Natural Gas (MPNG) announced on July 1, 2009 a nationwide increase in the refined petroleum products' controlled retail prices varying from 6%-9%. Petrol (gasoline) increased by Rs. 4 per liter from Rs 40.63 to Rs 44.63 in Delhi (about US$0.93 per liter or US$3.52 a U.S. gallon). Diesel went up by Rs. 2 per liter from Rs 30.87 to Rs 32.87 in Delhi ($0.68 a liter or $2.60 per gallon). Liquid petroleum gas (LPG - "cooking gas") and kerosene prices were left untouched, reflecting their perceived importance to the average citizen. The price hike in

refined product prices is the first since June 2008, just before the July 2008 peak in world crude prices near $140 a barrel when GOI-owned refiners and marketers faced large losses with the GOI selling oil bonds to cover part of the deficit or "under-recoveries." At that time, the average price of India's crude imports was $113 a barrel; refined product prices were cut in December 2008 and again in January 2009 when world crude prices fell to the $40s range.

¶8. (U) Although the new refined product prices still do not fully cover the expense of current world oil prices ($60 to $70 a barrel), the increase in the controlled prices is seen as a positive move and bodes well for the GOI reform process and better fiscal consolidation. The increase will help improve margins of the GOI-owned oil refining and marketing companies, which import crude at world prices but must sell refined products at GOI-controlled prices. MPNG officials say the GOI marketing companies can break even at the new price level when world crude prices are at $53 a barrel. GOI-owned exploration and production firms, such as India Oil Company and Oil and Natural Gas Corporation (ONGC), are also absorbing part of the marketing companies' losses. In another policy shift, the GOI plans to compensate the GOI product marketing companies mainly through direct budgetary provisions, whereas for the last few years, the GOI has depended largely on large volumes of off-budget oil bonds.

¶9. (U) The government and MPNG have signaled that deregulation of oil prices is on the GOI reform agenda. The GOI is considering allowing fuel retailers to adjust pump prices of petrol and diesel as long as the average price of crude oil used in domestic

refineries stays below $75 a barrel. Above that level, the GOI would step in. Even under the cap, refined product companies would not be allowed to increase retail prices beyond 15-20% at any one time. The frequency of fuel price revision will also be specified. During the annual budget session speech on July 6, Finance Minister Pranabh Mukherjee stated that the GOI will set up an expert group to advise on a viable and sustainable system of pricing refined products. With India depending on imports at world prices for over 75% of its crude oil consumption, domestic prices of petrol and diesel should be broadly in sync with global crude prices, he said.

Lower House of Parliament Passes Railway Budget

¶10. (U) India's Railway Budget for FY 2009-10, presented by Railway Minister Mamata Banerjee last week, was approved by the Lok Sabha (the lower house of parliament) on July 9. The budget, in a bid towards inclusivity, left passenger fares and freight rates untouched. Minister Banerjee plans to extend the rail network to every corner of the country and thus announced the introduction of 14 non-stop superfast trains, 57 new train services, extension of 27 trains, and the purchase of 18,000 new wagons in the current fiscal year. Banerjee pledged to establish more than fifty world-class stations (to be paid for through "innovative financing" and public-private partnerships), with shopping malls and budget hotels, as well as the addition of 375 "Model Stations" with improved basic amenities. Some of the other investment initiatives include mega logistic hubs in eastern and western dedicated freight corridors; a new coach factory and a 1,000 MW power plant in West Bengal and 43,000 acres of railway land bank to be used for industrial development. Minister Banerjee wants to set up an expert committee headed by Sam Pitroda, who heads the Knowledge Commission, to suggest innovations to utilize optic fiber cable networks of railways and take information technology to remote areas. All this opens up new opportunities for the infrastructure sector.

¶11. (U) Minister Banerjee's budget also promises improvement in passenger amenities, cleanliness, hygienic food catering and safety, as well as new information technology services. Some of the passenger amenities approved include introduction of air-conditioned double-decker coaches for inter-city travel, streamlining booking and charging extra on short notice scheme, concessional tickets for women, youth, students, journalists, low income groups, facilities for the handicapped and onboard availability of doctors and infotainment services. Computerized tickets are also supposed to be made available through post offices and mobile ticketing vans, with

automated ticket vending machines to be installed at 200 stations. Safety measures would include timely track renewal, modernization of signals and use of digital ultrasonic flaw detectors and integrated security at vulnerable stations.

¶12. (U) Budget figures indicate that revenues from freight and passengers fares remained sluggish last year, due to the economic slowdown and increased expenditure on salaries (railway staff of 1.4 million), on account of implementing the Sixth Pay Commission report. The Railways will be left with less investible surplus in FY 2009-10. Despite this setback, Banerjee has set the total investment plan for FY 2009-10 at Rs. 408 billion ($8.5 billion), up from Rs. 363 billion ($7.9 billion) in FY 2008-09. The Finance Ministry has approved issue of tax-free bonds by the Indian Railway Finance Corporation for the current year. That will give the Railways leeway to target borrowings of Rs. 92 billion ($2 billion) in the current year and also avail of budgetary support of Rs. 158 billion ($3.3 billion).

Reforms Have Life Outside the Budget

¶13. (SBU) Two days after the Budget disappointed many observers by its near silence on divestment and other reforms (reftel), the Economic Times claimed the Finance Minister sent a quiet signal on

divestment that the markets missed. A Finance Ministry official was cited as stating that some of the largest Indian state-owned companies may have to lower single-investor stakes, to meet a requirement the Finance Minister laid out in his Budget Speech that state-owned companies have a minimum 25% public shareholding. Meeting this threshold could obligate the government to lower the size of some of its holdings, in order to allow 25% of equity to be listed on the stock exchanges. This would in effect require divestment, a much anticipated reform by the markers.

¶14. (SBU) This quiet move is consistent with what new Planning Commission member Saumitra Chaudhury told econoff on July 8. He observed that it was Finance Minister Mukherjee's style to do things quietly and to avoid drama. As such, Chaudhury believed that the government would still go ahead with its stated reform agenda, but had decided the budget was not the proper place to take a stand on the issues. Further, Chaudhury opined that the budget omitted any mention of foreign direct investment (FDI) because the government still needs to resolve the confusion caused by Press Notes 2,3, and 4 earlier in the year on expanded FDI before it moves forward on retail or other sectors.

US -India Advance Cooperation on
Biofuels Program under the Energy Dialogue

¶15. (SBU) Under the U.S.-India Energy Dialogue's New and Renewable Energy Technology Working Group (NTRE-WG), the US Department of Energy (USDOE) and India's Ministry of New & Renewable Energy (MNRE) signed a Memorandum of Understanding on Cooperation in Biofuels Development on February 3, 2009 as previously reported. The purpose of the MOU is to establish a framework of cooperation covering scientific, technical and policy aspects of production, conversion, utilization, distribution and marketing of biofuels in a sustainable and environmentally friendly manner, in accordance with national priorities and socio-economic development strategies and goals. Mr. Zia Haq from USDOE's Office of Biomass Program visited New Delhi on June 29, 2009 and met with Indian official from MNRE and the Indian Oil Company (IOC) to share information on the USDOE's biofuels program and gain an understanding of the status and needs of the Indian biofuels program. Also participating in the meeting were representatives from Central Salt and Marine Chemicals Research Institute (CSMCRI), Indian Oil Corporation (IOC), General Motors (GM), Indian Oil Company, Praj Industries, Indian Council for Agricultural Research (ICAR), Defense Research and Development Organization (DRDO), and the Department of Biotechnology (DBT).

¶16. (SBU) Both sides agreed on preparatory steps towards implementation of the MOU. To begin with, MNRE will identify

biofuels experts and institutions and invite them to discuss and prioritize possible joint projects under the MOU. The group will include biologists, chemists, chemical engineers, and agricultural scientists among other professions. USDOE will similarly identify biofuels experts and institutions and discuss possible collaborative projects. An exchange of visits could take place by Indian and U.S. experts to either country for detailed interactions with their respective counterparts and visits to important research facilities and field projects. These activities will culminate in a joint workshop to be held in the United States in early December 2009 between officials and experts from both sides to discuss the projects short listed by the experts and to finalize specific projects that need to be included under the MOU. The workshop could be hosted at the USDOE National Renewable Energy Laboratory (NREL) in Golden, Colorado.

¶17. (U) Visit New Delhi's Classified Website: http://www.state.sgov/p/sa/newdelhi.

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